

# **REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE METSIMAHOLO LOCAL MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the financial statements of the Metsimaholo Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement for the year then ended, the statement of comparison of budget and actual amounts, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on the financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

### **Unqualified opinion**

5. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Metsimaholo Local Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

### **Emphasis of matters**

6. I draw attention to the matters below. My opinion is not modified in respect of these matters.

**Restatement of corresponding figures**

7. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during 2013-14 in the financial statements of the Metsimaholo Local Municipality at, and for the year ended, 30 June 2013.

**Irregular expenditure**

8. As disclosed in note 52 to the financial statements, the municipality incurred irregular expenditure of R119 135 537 (2013: R17 119 322) during the year under review due to non-compliance with supply chain management (SCM) regulations. The municipality investigated the completeness of irregular expenditure for the previous three years and made adjustments accordingly.

**Unauthorised expenditure**

9. As disclosed in note 50 to the financial statements, the municipality incurred unauthorised expenditure of R26 541 398 (2013: R7 227 972) during the year under review, due to overspending the municipal budget.

**Going concern**

10. Note 46 to the financial statements indicates that the Metsimaholo Local Municipality's current liabilities exceed the current assets by R667 421 (2013: R9 717 322). This indicates the existence of an uncertainty that may cast doubt on the municipality's ability to operate as a going concern.

**Material impairments**

11. As disclosed in note 5 to the financial statements, a provision for the impairment of debtors amounting to R16 444 359 (2013: R6 410 622) had been made with regard to irrecoverable receivables from non-exchange transactions. In addition, as disclosed in note 7 to the financial statements, a provision for impairment of debtors amounting to R69 039 462 (2013: R61 992 238) has been made with regard to irrecoverable receivables from exchange transactions.

**Material losses**

12. As disclosed in note 34 to the financial statements, material losses to the amount of R25 008 230 (2013: R11 313 622) were incurred as a result of distribution losses on electricity purchases

**Additional matters**

13. I draw attention to the matters below. My opinion is not modified in respect of these matters.

**Unaudited disclosure notes**

14. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. The disclosure did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

**Unaudited supplementary information**

15. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

16. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

### **Predetermined objectives**

17. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development objective presented in the annual performance report of the municipality for the year ended 30 June 2014:
- KPA 1. Service delivery and infrastructural development (on pages x to x)
18. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
19. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
20. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete
21. The material findings in respect of the selected development objective are as follows:

### **KPA 1 - Service delivery and infrastructural development**

#### **Usefulness of reported performance information**

22. The FMPPI requires that the performance indicators and targets must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 47% of the indicators were not well defined. This was because management did not adhere to the requirements of the FMPPI and a lack of proper systems and processes and technical indicator descriptions.

#### **Reliability of reported performance information**

23. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to the limitations placed on the scope of my work by the absence of information systems, the auditee not being able to provide sufficient appropriate evidence in support of the reported performance information, and the auditee's records not permitting the application of alternative audit procedures.

#### **Additional matter**

24. I draw attention to the following matter. My conclusion is not modified in respect of this matter:

### **Achievement of planned targets**

25. Refer to the annual performance report on pages x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the adverse or disclaimer of opinions expressed on the usefulness and reliability of the reported performance information in paragraphs 22 to 23 of this report.

### **Compliance with laws and regulations**

26. I performed procedures to obtain evidence that the entity had complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key applicable laws and regulations, as set out in the general notice issued in terms of the PAA, are as follows:

### **Strategic planning and performance management**

27. The performance management system and related controls were not in place as it did not describe and represent the processes of performance planning, monitoring and reporting and how it is conducted, organised and managed, including determining the roles of the different role players, as required by section 38 of the Municipal Systems Act and regulation 7 of the *Municipal planning and performance management regulations*.

### **Annual financial statements, performance and annual reports**

28. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of commitments and irregular expenditure identified by the auditors in the submitted financial statement were subsequently corrected and the supporting records provided, resulting in the financial statements receiving an unqualified audit opinion.
29. The annual performance report for the year under review does not include the performance of the municipality and each external service provider, a comparison of the performance with set targets, a comparison with the previous financial year and measures taken to improve performance as required by section 46 (1)(a), (b) and (c) of the Municipal Systems Act.
30. Financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126 (1)(a) of the MFMA.

### **Expenditure management**

31. Money owed by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
32. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

### **Asset management**

33. Capital assets were permanently disposed without the approval of the council as required by section 14 (2)(a) of the MFMA.

### **Consequence management**

34. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32 (2) (a)(ii) of the MFMA.
35. Authorisation of unauthorised expenditure was not done through an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.

### **Procurement and contract management**

36. Quotations were accepted from prospective providers who were not registered on the list of accredited prospective providers and did not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
37. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM regulations 21(b) and 28(1)(a) and the preferential procurement regulations.
38. Awards were made to providers who were in the service of other state institutions or whose directors/ principal shareholders were in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulation 44. Similar awards were identified in the previous year and effective steps were not taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
39. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

### **Human resource management and compensation**

40. An acting chief financial officer was appointed for a period of more than three months without the approval of the MEC for local government, in contravention of section 56(1)(c) of the Municipal Systems Act.

### **Environmental waste management**

41. The municipality operated their waste disposal sites without a waste management licence or permit, in contravention of subsection 20(b) of the National Environmental Management: Waste Act of South Africa, 2008 (Act No. 59 of 2008).

### **Internal control**

42. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

43. The occurrence of material irregular expenditure during the year under review indicates that integrity and ethical values were not adequate to prevent irregular expenditure and to set the standard for sound corporate governance, as they were not prevented by management.
44. The accounting officer did not take appropriate action to address the lack of discipline at the SCM section, resulting in non-compliance with applicable legislation. This occurred due to limited capacity at the SCM unit.
45. The accounting officer did not take the appropriate steps to ensure that the legislated deadlines were met for the submission of the financial statements due to labour unrest impacting the municipality over the period of June and July when year-end procedures, closing off of the general ledger, reconciling of account balances, and preparation of the year end audit working papers should have been performed.
46. Internal policies and procedures for performance information management were not developed, approved and implemented due to a slow response by management on the recommendations in the previous audit report.

## Financial and performance management

47. The financial statements were subjected to material corrections resulting from the audit process, which are attributable to weaknesses in the municipality's design and implementation of internal controls for financial management and financial reporting, and weaknesses in the information systems.
48. The action plan that was in place to address shortcomings in the performance management and compliance process was not effective due to a lack of monitoring by management.
49. The municipality did not have a proper system of record management to maintain information that supports the reported performance due to a lack of capacity in the performance information unit.

*Auditor - General*

Bloemfontein

20 January 2015



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*